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Between primaries and Palins, crunches and crashes, 2008 was a turbulently historic year to say the least. With the world economy going from troubling to alarming, and conflicts sparking in the Caucasus and the Middle East, there was little rejoicing beyond the groundbreaking US elections, with the ascension of an African American to the highest office in the world.

The economic slump – which many predict will continue well into the middle of 2010 – may mean that taxation in both France and the US will see only minor, and likely unfavorable, adjustments in the coming years: With both federal and local governments strapped for cash in the US, the tax cuts administered by President Bush in 2001 and 2003 will likely be allowed to expire by the Obama administration at the end of 2010. Afterwards, long-term capital gain rates may rise above their current 15% level to 20% or higher, while changes to estate taxation rules should set a permanent exemption amount and rates for estates above that amount. In France, the swooping changes made by Sarkozy under his *Paquet fiscal* came at a pre-recession time when the French government had high aspirations for its country's economic future. Given the turn in events, the UMP-led administration may be unable to make major tax-favorable adjustments in the next few years, and, as evidenced by recent tax laws, will likely seek monies wherever they can be found.

Highlights of tax law changes affecting 2008 returns and 2009 income are summarized below:

US Tax Law Developments

Like so many life preservers tossed into a turbulent sea, the slew of new tax laws passed throughout 2008 are meant to help individuals and businesses weather the ongoing recessive storm. With wishful thinking titles like the "Housing and Economic Recovery Act" or simply, the "H.E.A.R.T. Act", most of them offer up new or renewed tax incentives affecting both 2008 US tax returns and 2009 tax planning (although some provisions, like the "exit tax", may be detrimental to overseas tax payers). Below is a summary of the major changes concerning individuals:

"Exit Tax" for Expatriating US Citizens or "Green Card" Holders

As of June 17th, 2008, certain US citizens or long-term residents ("green card" holders) who relinquish their US status may be subject to an "exit tax" – that is, a capital gains tax on the deemed sale of their worldwide assets – at the moment of expatriation. The "exit tax" replaces the Alternative Tax Regime, which previously subjected certain expatriates to maximum taxes on their US-source income for the 10-year period following their expatriation. Since the new "exit tax" regime is both complicated and potentially burdensome for certain taxpayers, we strongly recommend that you contact us to calculate the cost before deciding to expatriate.

First-Time Homebuyer Tax Credit

For principal residences purchased between April 9, 2008 and July 1, 2009, a tax credit equal to 10% of the property purchase price is available for qualifying buyers. The maximum credit will be \$7,500 (\$3,750 for married individuals filing separately), but will phase out for taxpayers with Adjusted Gross Income (AGI) above \$75,000 (for individuals) and \$150,000 (for joint filers). Credits will not be given directly at property closings, but can be claimed on either 2008 or 2009 tax returns. Note that the term "first-time homebuyer" includes any person who did not own a principal

residence for the three-year period prior to the new purchase. The credit will not apply to Nonresident Alien (NRA) taxpayers, and will not apply to US taxpayers purchasing principal residences overseas.

Stimulus Rebate Checks

Certain taxpayers may have qualified for a rebate of their 2007 taxes under the Stimulus Act of 2008, and should have received a rebate check sometime after filing their 2008 returns. The rebate amounts vary per taxpayer and are normally phased out for high earners, with a maximum rebate of \$600 for unmarried persons and \$1,200 for married couples, plus an additional \$300 credit per qualifying child. For those taxpayers who did not receive their full rebate in 2008, they may still receive the refund in 2009 if they qualify for the credit and file their 2008 returns.

Additional Standard Deduction for Real Property Taxes

For tax years 2008 and 2009, an additional standard deduction of \$500 for individuals (\$1,000 for joint filers) will be available for taxpayers who do not otherwise opt to itemize their deductions on Schedule A. Thus, the total standard deduction amounts for 2008 will now be \$5,950 for single individuals, \$8,500 for head of household filers, and \$11,900 for joint filers.

Alternative Minimum Tax (AMT) “Patch”

As was the case for 2007, Congress passed a last-minute provision that will prevent millions of low and middle-income tax payers from being subjected to Alternative Minimum Tax (AMT) on their 2008 returns. The bill will increase – for tax year 2008 only – the exemption amounts above which taxpayers fall under the AMT regime: In the case of single taxpayers, the exemption increases from \$44,350 to \$46,200; in the case of married couples filing jointly, the increase is from \$66,250 to \$69,950. Note that without this temporary “patch”, the 2008 AMT exemption amounts would have reverted to the pre-2001 levels of \$33,750 and \$45,000 respectively.

A Hold on Required Minimum Distributions for IRAs

For taxpayers with tax-deferred retirement savings accounts such as a 401(k) plan, a 403(b) plan, or an IRA, minimum annual distributions are required when they reach the age of 70½. The amount of the distribution is calculated based on the account’s balance of the preceding year, and the IRS can impose a 50% excise tax if a minimum distribution is not made. For tax year 2009, the distribution requirement is suspended, seemingly to allow accounts to grow after heavy losses suffered by taxpayers throughout 2008.

Education Incentives

Both the Higher Education Tuition Deduction and Teachers’ Classroom Expense Deduction have been extended through December 31, 2009. The tuition incentive allows for an above-the-line deduction of higher education expenses, with a maximum deduction of \$4,000, and phase outs for taxpayers with AGI exceeding \$65,000 (\$130,000 for joint filers). The teachers’ incentive allows educators to take an above-the-line deduction of up to \$250 for classroom expenses.

State and Local Sales Tax Deduction

Congress has extended the state and local sales tax deduction for 2008 and 2009 returns. The deduction may be taken in lieu of the state income tax deduction, and taxpayers may opt between deduction actual sales tax expenditures or taking a flat deduction based on their state’s standard sales tax rate. Note that this deduction is not available for foreign sales taxes such as French VAT.

French Tax Law Developments

Following the wide-ranging *Paquet fiscal* passed by the Sarkozy administration in 2007, this year's *Loi de finances pour 2009* and *Loi de finances rectificative pour 2008* make only minor and mostly unfavorable changes to existing laws. These and other developments, including new incentives for arriving "impatriates", are summarized below:

Increased Contributions Sociales

The rate of *Contributions sociales* (CSG/CRDS/PS) has been increased, from 11% to 12.1%, for investment income and capital gains reported on the 2008 French tax declaration, as well as investment income subject to tax withholding in 2009. The 1.1% increase results from the new *Revenu de Solidarité Active* (RSA) which, like other such "social contributions", is actually just an additional tax given a "tolerable" name, and created primarily to finance the *Revenu Minimum d'Insertion* (RMI).

Capping of Niches fiscales

Starting January 1, 2009, the various *niches fiscales* (tax shelters) -- which taxpayers can use to offset their income tax by investing in various government-designated entities, services, and home improvements -- have been limited to an annual tax benefit of €25,000, plus 10% of one's net taxable income. Note that this limitation applies to most of the *niches fiscales* (SOFICA, FCPI, FIP, "Malraux" restorations, child care expenses, student loan interest deductions, etc.) but does not apply to charitable contributions, tuition expense deductions or the earned income credit (*Prime pour l'emploi*).

Changes in Furnished Rental Regime

For tax years 2009 onwards, the furnished rental regime (*location meublée*) has been modified as follows: In order to hold the status of "professional landlord" (*louer professionnel*) -- which allows for an unlimited deduction of rental losses against other income -- one must be officially registered as a *louer professionnel* on the local *registre du commerce et des sociétés*, and one's annual furnished rental receipts must exceed €23,000 and the total of other annual income. If you do not have the "professional landlord" status, then your furnished rental losses can only be deducted against other furnished rental gains, or else carried forward for up to 10 years against such income. Also, the Micro-BIC regime for furnished rentals has been restructured so that only those with less than €32,000 in annual gross rents can qualify, while the standard annual deduction has been decreased from 71% to 50%.

New Incentives for Incoming "Impatriates"

As part of the 2008 *Loi de modernization de l'économie* (LME), several new incentives were adopted to lure foreign executives and other qualified workers to the French job market. The principal provision allows qualified "impatriates" an exemption from French wealth tax (ISF) of all non-French source assets for the first five years of their French residency (note that a similar provision already exists under the US-French Treaty for incoming US citizens). Other provisions allow qualified "impatriates" to benefit from the *bouclier fiscal*, and to exempt their non-French source income from the *bouclier* calculation for the period prior to "impatriation"

New Regime for Self-Employed Persons

Starting in 2009, The LME has also established a new and highly simplified tax and social charge regime known as the *auto-entrepreneur*. The regime is available for self-employed persons with annual gross income of up to €80,000 for sales and lodging services, and €32,000 for all other services. After declaring their new activity on-line (and without having to register at their local *registre du commerce*), *auto-entrepreneurs* can benefit from either a 12% (for commercial activities) or 21.3% (for other activities) rate of social charges, a fixed monthly or quarterly tax withholding of between 1% and 2.2%, an exemption from VAT, and an exemption from the *taxe*

professionnelle for the first two years of business. For more information and to see if your new business can qualify, please visit the following website: www.auto-entrepreneur.com .

Increased Penalties for Undeclared Foreign Bank Accounts

The penalty for not declaring a foreign bank account on your annual French tax declaration (form n° 3916) has been increased from €750 to €1,500, and to €10,000 when the bank account is held in a country that does not have a tax treaty with France (usually a tax haven or “offshore” bank). The penalty has also been increased, from €750 to €1,500, for foreign life-insurance contracts that are not declared annually. Furthermore, the statute of limitations for French tax audits with regards to undeclared foreign-source income and bank accounts has been increased from three to ten years.

US Cracks Down on Offshore Accounts

Following the November 2008 federal indictment of UBS private bank chief Raoul Weil, the IRS and Justice Department have begun investigating over 19,000 UBS clients who may have evaded US tax-reporting requirements by holding funds in undisclosed Swiss accounts. In order to avoid civil and possibly criminal penalties, account holders are advised to voluntarily come forward to the IRS and pay any back taxes, penalties and interest resulting from previously unreported income generated by such accounts. The Justice Department has recently opened up its inquiry to the private banking services of Credit Suisse and HSBC, and other offshore banks may be added to list. We therefore urge US taxpayers holding such accounts to seek professional advice for disclosing them as soon as possible, and are prepared to assist interested parties in such matters.

New US-France Income Tax Protocol

On January 13, 2009, a new protocol to the 1994 US-France Income Tax Treaty was signed by representatives of both countries' governments. The protocol's major provision eliminates withholding tax on dividends paid to a beneficiary company that owns at least 80% of the payor company. An additional provision eliminates withholding tax on cross-border royalty payments. Other areas covered by the protocol include changes to the limitations on benefits and exchange of information provisions.

Finally, it seems that the protocol has once again modified Article 18 (Pensions) of the Treaty so that, as was the case prior to tax year 2007, French pensions received by US citizens residing in France will not be taxable in the US. This is a welcome correction and a sign that despite the morose economic outlook, there may still be some good news to come in 2009...

HAVE A SAFE AND FRUITFUL 2009!!
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